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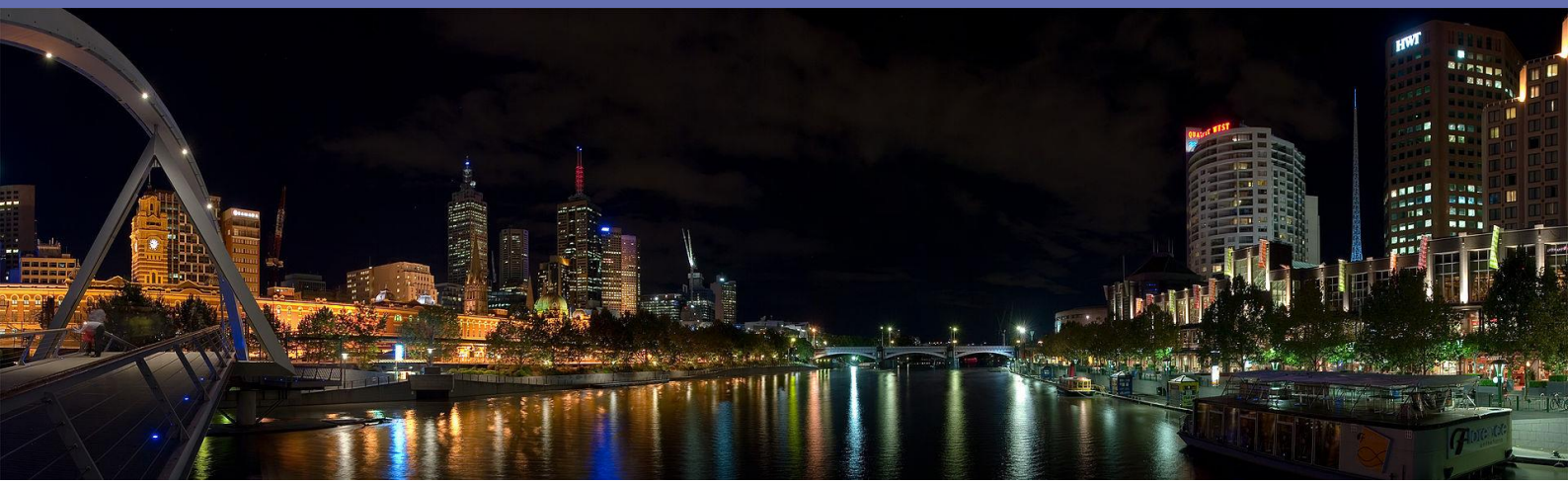

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The Fundamental Importance of Foreign Direct Investment to Australia in the 21st Century: Reforming Treaty and Dispute Resolution Practice*

This paper outlines our collaborative research project for 2014-16, aimed at evaluating the economic and legal risks and benefits associated with the Australian Government's recent approach to investor-state dispute settlement (ISDS), and broader implications for Foreign Direct Investment (FDI) and international investment law particularly in the Asian region. The multidisciplinary research will include econometric modelling, empirical research through stakeholder surveys and interviews, as well as critical analysis of case law, treaties and regulatory approaches. The aim of this project is to identify optimal methods of investor-state dispute prevention, avoidance and resolution that efficiently cater to inbound and outbound investors as well as Australia as a whole. The goal is to promote a positive climate for investment inflows and outflows, while maintaining Australia's ability to take sovereign decisions on matters of public policy. The authors welcome feedback from readers, and especially any opportunity for interviews with readers or other individuals and organisations with practical experience of international investment dispute management.

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Introduction: Project Aims and Background

Foreign direct investment (FDI) has become essential to global economic development, with FDI flows exceeding US$1.5 trillion in 2012 (UNCTAD 2012).[5] Australia's treaty-making practice, especially along the lines of the 2011 "Gillard Government Trade Policy Statement" eschewing investor state dispute settlement (ISDS) provisions in future treaties,[6] may be sub-optimal as it is not entirely based on sound cost-benefit analyses data and supporting legal research. The policy of pursuing trade and investment agreements that exclude ISDS puts Australia against the global trend. One important question is whether this impacts Australia's ability to attract FDI.[7]

Our project **aims generally** to develop a key policy framework and devise salient institutional structures and processes that take account of two competing pursuits: the cost-benefit advantages of promoting Australia as an FDI destination; and the need to ensure that these advantages are considered in light of competing policy objectives that are not explicated exclusively on economic grounds. This project is valuable and innovative because it identifies significant gaps in the current Australian policy framework and uses interdisciplinary research to address them. It will also have implications for investment treaties and governance of FDI more broadly.

The overall purpose is to ensure that Australia remains an attractive destination for FDI and does not deter investors in the context of competing policy objectives. As such, the project will evaluate the economic and legal risks and benefits associated with the Australian Government's current policy on ISDS through multidisciplinary research, namely (i) econometric modelling, (ii) empirical research through stakeholder surveys and interviews, as well as (iii) critical analysis of case law, treaties and regulatory approaches. The basic objective is to identify optimal methods of investor-state dispute prevention, avoidance and resolution that efficiently cater to inbound and outbound investors as well as to Australia as a whole. The **specific purposes** therefore are to:

1) investigate policies that underpin Australia's approach to negotiating international investment treaties, with particular emphasis on its policies on avoiding, managing and resolving investment disputes;
2) identify and analyse links between these policies and the investment practices of both inbound and outbound investors; and
3) propose recommendations on alternative approaches to investment policy;

so that, through a carefully framed cost-benefit analysis, Australia can retain appropriate sovereignty over public policy issues (such as public health and the environment) while promoting a positive economic climate for investment inflows and outflows.

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5. For updated data and analysis, see eg http://unctad.org/en/Pages/DIAE/Research%20on%20FDI%20and%20TNCs/Global-Investment-Trends-Monitor.aspx.
6. See "Gillard Government Reforms Australia's Trade Policy" (Media Release, 12 April 2011), http://trademinister.gov.au/releases/2011/ce_mr_110412.html. The hyperlink to the Trade Policy Statement no longer functions, but the Statement can still be accessed at http://pdf.aigroup.asn.au/trade/Gillard%20Trade%20Policy%20Statement.pdf or via http://blogs.usyd.edu.au/japaneselaw/2013/11/arc.html.
7. Abbott's Coalition Government, which took power from the Labour Government in Australia's general election of 7 September 2013, has distanced itself from the Trade Policy Statement released by the (Labour-led) Gillard Government in April 2011, including with respect to treaty-based ISDS. The Statement has been expunged from government websites and, in January 2014, the Abbott Government released "Frequently Answered Questions" on ISDS, explaining that it "will consider ISDS provisions in FTAs [and presumably other investment treaties] on a case-by-case basis" (https://www.dfat.gov.au/fta/isds-faq.html). Australia subsequently did not include ISDS provisions in its FTA with Japan agreed in April and signed in July 2014 (http://www.eastasiaforum.org/2014/04/09/why-no-investor-state-arbitration-in-the-australia-japan-fta/). By contrast, it did so for the FTA concluded with Korea in December 2013 and signed in April 2014 (http://www.eastasiaforum.org/2014/01/01/arbitration-rights-back-for-the-south-korea-australia-fta/), with the Australian Government stating that it "has ensured the inclusion of appropriate carve-outs and safeguards in important areas such as public welfare, health and the environment" (http://www.dfat.gov.au/fta/akfta/fact-sheet-key-outcomes.html). However, Labor Senator Penny Wong (Opposition Leader in the Senate) was reportedly concerned about the impact of "any" proposed ISDS mechanism: Gareth Hutchens, "South Koreans Free to Sue Thanks to New Free Trade Agreement" (6 December 2013) at http://www.smh.com.au/national/south-koreans-free-to-sue-thanks-to-new-free-trade-agreement-20131205-2ytx1.html. In September 2014, Labor members of the parliamentary Joint Standing Committee on Treaties (JSCOT) issued a dissenting Report, recommending against ratification of KAFTA partly because of concerns over its ISDS provisions, which jeopardises the capacity of the Abbott Government to ratify the treaty because it lacks a majority in the Senate. However, in August 2014, Labor members of the Senate's Foreign Affairs, Defence and Trade Legislation Committee agreed with the Coalition members' recommendation that a Greens Party private member's *Trade and Foreign Investment (Protecting the Public Interest) Bill 2014*, which would have precluded Australia from entering into any future investment treaty containing ISDS provisions, should not be enacted (see http://kluwerarbitrationblog.com/blog/2014/08/27/the-anti-isds-bill-before-the-australian-senate/). Compared to the Coalition members' report, those Labor Party Senators's additional comments identified greater risks associated with ISDS, but also the executive's constitutional authority and responsibility to negotiate treaties. (For an analysis based on submissions and evidence at those Senate Committee hearings, see Nottage 2015.) Accordingly, there is ongoing political controversy over ISDS, including significant media interest (see eg http://www.abc.net.au/radionational/programs/backgroundbriefing/isds-the-devil-in-the-trade-deal/5734490, 14 September 2014), generating interesting contrasts and parallels with some other countries including within the Asia-Pacific region. Our project therefore remains important because it will: (a) guide the negotiation and drafting of ISDS provisions in future Australian treaties, (b) realistically assess alternatives and reforms to the ISDS system, (c) influence the approach of other states (or indeed future Australian Governments) towards treaty-based ISDS.

By way of **general background**, FDI flows involve cross-border investment and inevitably result in some cross-border disputes, becoming especially problematic when such disputes are with the 'host' state (the state where the investment has been made). Domestic, regional and international investment markets are becoming increasingly integrated and interdependent. A corollary is that a healthy flow of FDI into and out of investment markets directly impacts on a variety of economic sectors (Trakman & Ranieri 2013, chs 1–2). FDI is a key ingredient to sustainable economic growth (Sun 2002). In particular, an increase in FDI share leads to 'higher additional growth in financially developed economies' (Alfaro et al 2010). The significance of FDI is even greater since the Global Financial Crisis of 2008 (GFC) and advanced economy slowdown.[8] Competition is now growing among states to attract cross-border investment, notably relating to capital and support infrastructure investments which are directed at providing financial stability and sustaining liquidity in investments. Australia has been able to develop a competitive, economically efficient and technological advanced resources sector and become a major global supplier of raw materials due to FDI.

Investor-state arbitration (ISA) provisions are now commonly included in investment treaties around the world (Nottage & Weeramantry 2011). [9] Essentially, ISA is perceived to act as a risk-minimisation strategy for investors by allowing them the facility to institute claims against host states directly when states allegedly breach their international law obligations. The knowledge that there are robust processes to resolve disputes can attract investment into the host state. ISA is also perceived as avoiding the social and political cost associated with domestic litigation, including the publicity of open hearings. It enforces substantive protections agreed among states under public international law, and ISA is seen as being efficient in not requiring investors to mobilise their 'home' states to initiate inter-state claims on their behalf (under customary international law in limited circumstances, or the World Trade Organization (WTO) with respect to investments in some services sectors, or other trade-related investment treaties). Critically, ISA provisions are viewed as obviating the need to seek domestic law remedies through the local courts of the host state, which may be seen as being less impartial and specialized in comparison to international arbitral tribunals. [10] The justification for ISA may reasonably depend on the quality of host country institutions such as the independence of domestic courts, the rule of law and the development of the judicial system.

The pros and cons of ISA are debatable (Waibel ed, 2012). [11] Especially for a state like Australia, ISA mechanisms involve a balancing exercise between two competing pursuits – each of which has social, economic and legal costs and benefits. The first relates to providing foreign investors with a robust formal procedure through which they can enforce their substantive protections efficiently and free from state incursion, thereby offering them reduced risk incentives to invest in Australia. Treaties containing ISA are inferentially even more valuable for Australian outbound investors, as these investors feel comforted that host states will be less likely to subject them to discriminatory or corrupt practices.

The **second** and competing objective is to ensure that Australia retains appropriate sovereignty to legislate on public policy issues, such as health and the environment. Arguably, giving foreign investors the ready ability to institute international ISA claims against Australia potentially compromises the Australian Government's ability to devise effective measures around these public policy issues, leading to a state of 'regulatory chill' (Tienhaara 2012). The issue of public health has been recently canvassed in Australia through the plain packaging legislation and the disputes surrounding it (Nottage 2013). The issue of the environment is likewise significant in a resource-rich country that invites investment in mining, oil and gas (UNCTAD 2012).

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8. Relatedly, investment treaties acted as an important bulwark against the temptation of states to practice damaging economic protectionism in the immediate aftermath of the GFC: see Kurtz and van Aaken (2009).
9. Over 1800 "Bilateral Investment Treaties" (BITs, including 21 in force for Australia) can be freely searched and downloaded via http://www.unctadxi.org/templates/DocSearch.aspx?id=779. In addition, all of Australia's Free Trade Agreements (FTAs) include ISDS, except for those with three developed countries (the US, New Zealand and Japan): see texts available via http://www.dfat.gov.au/fta/. For an overview of key features of Australia's BITs and ISA mechanisms found in its FTAs, see Mangan (2010). For investment treaty practice and drafting of other major economies, see (Brown ed, 2013).
10. For a concise summary of these perceived benefits and ways to manage potential adverse effects, from the European Commission, see "Factsheet on Investor-State Dispute Settlement" (3 October 2013) at http://trade.ec.europa.eu/doclib/docs/2013/october/tradoc_151791.pdf; and its discussion paper for a Public Consultation on ISDS in the EU-USA FTA presently under negotiation (until July 2014, at http://trade.ec.europa.eu/consultations/index.cfm?consul_id=179; cf also Nottage, 2015).
11. See also now Eberhardt et al (2012); UNCTAD (2013); Campbell et al (2013) at http://ssrn.com/abstract=2280182; Nottage (2014).

In the important but controversial Trade Policy Statement released in April 2011 by the former Gillard Government, Australia changed its longstanding investment treaty practice regarding ISA, noting that it 'does not support provisions that would confer greater legal rights on foreign businesses than those available to domestic businesses'. The then Government stated that it would not 'support provisions that would constrain the ability of Australian governments to make laws on social, environmental and economic matters in circumstances where those laws do not discriminate between domestic and foreign businesses.' As a result, the Gillard Government announced that it would 'discontinue' the practice of including ISDS procedures (including ISA provisions) in trade and investment agreements. [12] Yet, other than a few states in Latin America (Ecuador, Bolivia and Venezuela) that reject ISA, a few countries that do not provide for it (notably Brazil) and recent intimations by South Africa to reject it as well, [13] most countries – including now in Asia – include ISA provisions to decide disputes based on treaty and customary international law – largely 'delocalized' from domestic legal systems (Trakman 2012b).[14]

In issuing its Policy at odds with the treaty practice of the overwhelming number of states in the international community, the Australian Government relied on a report produced in 2010 by the Australian Productivity Commission (PC).[15] However, the data and analysis were potentially incomplete or even flawed (as outlined in Part 2 below). Our project therefore adopts an interdisciplinary approach to explore the economic, political and legal risks engendered by Australia's new Policy. Based on our findings, we will then make recommendations, in consultation with government, business and other stakeholder groups, on effectively redressing those risks.

Project Outline

Our project can be summarised in three key propositions:

(a) There is presently insufficient data and analysis of the links between FDI and Australia's treaty making practice, especially its position on ISDS, in order to justify or negate its current policy standpoint;
(b) Economic and legal research is necessary in order to supply this data so that Australia can avoid deterring FDI and remain an attractive FDI destination while ensuring that it is able to take sovereign decisions on issues of public policy; and
(c) This project can deliver the data and analysis necessary in order to formulate efficient policies in this area, based on sound multidisciplinary research.

We will do this by analysing key socio-economic and political risks associated with Australia's Policy in light of two issues. First, what, if any, broader issues, including risks and costs, surrounding **treaty practice** arise from Australia's policy shift? Second, what are the potential costs and benefits of its new policy on **FDI flows**, both inbound and outbound? By investigating these questions, we will be able to identify the links between Australia's investment treaty making practice and its ability to cultivate FDI, while preserving its ability to take sovereign decisions on public policy grounds that are socially and economically desirable.

Treaty Practice

Risks investigated:

Australia is currently negotiating or has recently concluded important Bilateral Investment Treaties (BITs) and especially Free Trade Agreements (FTAs) with countries including China, Japan and Korea – each of which has agreed to extensive ISA protections in almost all their recent

12. Australia's FTA with Malaysia, concluded in 2012, consequently omitted ISDS (instead only including an inter-state arbitration process to resolve investment claims against the host state). But Australia's outbound investors into Malaysia retain significant protections anyway under the 2009 ASEAN-Australia-NZ FTA: see eg Bath and Nottage (2014) at http://ssrn.com/abstract=2331714. The Gillard Government, curiously, did not attempt to renegotiate any past investment treaties that had included ISDS (even in more rudimentary forms).
13. Carim (2013). See also http://www.bdlive.co.za/business/2013/10/31/bill-to-limit-arbitration-for-foreign-investors (31 October 2013).
14. Indeed, the European Commission has recently affirmed that ISA must form part of any high-quality investment treaty entered into by the European Union (albeit accompanied by substantive and procedural delimitations to safeguard key regulatory autonomy) (EC 2013). By contrast, Indonesia has recently informed the Netherlands that it did not wish to renew its bilateral BIT (and indeed indicated that it would review all of Indonesia's BITs as they came up for renewal): http://indonesia.nlembassy.org/news/2014/03/bilateral-investment-treaty%5B2%5D.html (13 March 2014); http://kluwerarbitrationblog.com/blog/2014/08/21/indonesias-termination-of-the-netherlands-indonesia-bit-broader-implications-in-the-asia-pacific/.
15. Available via http://www.pc.gov.au/projects/study/trade-agreements/report.

investment treaties (Eliasson 2011; Hamamoto & Nottage 2011; Bath & Nottage 2011; Trakman 2013a). It is arguable that, if Australia persists with the 2011 Trade Policy approach to ISDS, particularly in light of these three countries' strong interest in securing better access to Australia's resources sector, including through capital investment, Australia risks delaying or even derailing negotiations to expand its FTA partners.[16] The same risk potentially arises in respect of Australia's participation in the Trans-Pacific Partnership Agreement (TPPA), dominated by the US (Trakman 2013b);[17] and in the Regional Comprehensive Economic Partnership (or 'ASEAN+6' FTA: including China, Japan, Korea, India, Australia and New Zealand) under negotiation since November 2012 (Trakman & Sharma 2014).

An Australian policy against any forms of ISA in all future treaties may have a trail of social-political and economic costs. It can destabilize Australia's treaty-making capabilities, extending well beyond the actual availability of ISA. It can impact on the content of investment agreements generally, including the costs and benefits arising from substantive protections and remedies to which Australia agrees. It can affect which states are willing to enter into negotiations with Australia, as well the costs arising from demands they may make in return for agreeing to Australia's position on ISA (thereby potentially limiting valuable gains of strategic interest to Australia). Without proper analysis of the costs and benefits of investment treaty design, there is potential to distort investment flows, adversely influence public policy and even impact political relations between Australia and other countries.

In order to address these risks, this project will consider the following issues:

Treaty Making and Interpretation

1. The crucial economic, political and social significance of Australia's investment treaties.
2. Should Australia adopt its own Model Investment Treaty? What are the economic, social and political benefits of it doing so?

Key Provisions in Investment Treaties and Their Interpretation

1. How should the scope and operation of investment treaties be delineated through, for instance, the definition of protected 'investment', 'investor' and 'expropriation'?
2. What position should Australia adopt on relative and absolute standards of treatment to be conferred on foreign investors?
3. How should Australia work to secure its domestic interests and issues of public policy, including health and the environment?

Effects on FDI and Investor Practice

Risks investigated:

Australia's position with respect to ISA can directly affect investment practices. As a resource-rich country, Australia can benefit significantly from expanded inbound investment. Simultaneously, Australian businesses can benefit from investing in foreign jurisdictions (UNCTAD 2012).

On the negative side, Australia's Trade Policy carries distinct risks. It can engender the perception that Australia is not hospitable to **inbound** foreign capital investors. Inbound investors in local markets may withdraw, or fail to commit, capital investments in Australia by assuming that their investments will become subject to domestic public policy requirements enforced by domestic judges in accordance with domestic laws and procedures that may be contrary to business interests without a public policy justification. They may value the benefit of expert international tribunals that apply international investment law in ISA proceedings. The perceived negative consequence of Australia's policy against ISA is therefore economic and political: in potentially

16. See generally Armstrong 2011; Kurtz 2012; Nottage 2011; Burch, Nottage & Williams 2012; Trakman 2013b; Trakman and Sharma 2014. Another possibility is that Australia "gives up" some more important benefit from future FTAs in order to "opt-out" of ISDS protections. Some media commentary on these points over 2012-2013 is available via http://blogs.usyd.edu.au/japaneselaw/2013/10/isa2013.html and http://blogs.usyd.edu.au/japaneselaw/2012/12/negotiating_and_applying_inves.html.
17. Australia's Trade Minister under Abbott's Coalition Government, Andrew Robb, has reportedly said that despite agreeing to ISDS in the FTA concluded with Korea on 5 December 2013, he still intended to hold out against ISDS in the TPP "until he received a good price" in return.
"If there is a substantial market access offering, and if we can also succeed in getting exclusions and protections to safeguard certain public policy measures then we will be prepared to put it on the table, but it is not on the table yet."
Asked whether that meant Australia needed something in return, Mr Robb said: "That's right."
The gains would need to provide extra market access to the US, Japan, Canada, or any of the other eight nations. Questions of intellectual property and access to medicines were "red-line issues".
"We will not do anything to increase the cost of the Pharmaceutical Benefits Scheme," Mr Robb said.
See Peter Martin, "Robb to Tackle Trans Pacific Partnership" (6 December 2013) at http://www.smh.com.au/business/robb-to-tackle-trans-pacific-partnership-20131205-2yttu.html.

marginalizing foreign capital and financial interests in favour of domestic public policy (Trakman 2012a; 2014a).

Outbound Australian investors, in turn, may envisage the risk of their capital investments eroding, or being confiscated by foreign governments in litigation before the domestic courts of host states. Under the new Policy, Australian outbound investors may need to assess the cost of managing capital and related financial risks associated with foreign investment. The Policy explicitly states that '[i]f Australian businesses are concerned about sovereign risk in Australian trading partner countries, they will need to make their own assessments about whether they want to commit to investing in those countries.'

A clear risk is that this Policy may alienate peak business groups, such as the Australian Chamber of Commerce and Industry (ACCI). [18] They may envisage significant political and financial risks to outbound Australian investors in having to rely on courts in partner countries that lack a sustained 'rule of law' tradition or have high 'corruption' indices recorded by such organizations as the World Bank. The issue is how efficiently and reliably outbound investors can assess the capital and other financial risks of investing in foreign markets, in deciding if, how and to what extent to commit in target countries, and in securing protection against financial risks associated with those investments over the life of the capital investment (Kurtz 2012; Nottage 2013; Trakman 2014).

Whether or not Australia is truly unfriendly to foreign investors, an economic and political risk is that Australia's position on ISA may generate the *perception* that its policy carries real financial risks and costs to inbound and outbound investors. Given the vulnerability of international markets to investor perception, this shift in policy, therefore, can have a very real macro-financial impact on capital markets that depend on infrastructure and related capital investments from inbound and outbound Australian investments (Trakman & Ranieri 2013, chs 2-3).

In response to these threats, we will study key risk management issues faced by Australia as a whole, as well as inbound and outbound investors:

Key Issues in Risk Management for Inbound and Outbound Investors as well as for the Australian Government

1. How should inbound and outbound investors assess economic and political risks (where can they find out such information and what should they do with it)?
2. How should they measure such risks?
3. How should they gather information on changing risks (where to get it, and how to use it effectively)?
4. How valuable is political risk insurance to such investors (self-insurance, government and private indemnity insurance, and other risk management strategies)?
5. What are the costs of securing the 'right' kind of insurance, at the 'right' price and time (e.g. in advance of risks materializing into a loss)?
6. What role should the Australian government play in such risk management?

Dispute Avoidance Measures in Investor–State Relations

1. What dispute avoidance measures should states and investors adopt in managing such risks?
2. Where and how should they provide for these measures (e.g. by treaty or contract)?
3. What are the costs and benefits of treaties providing for informal negotiation measures?
4. Should investment treaties or contracts provide for the appointment of qualified conciliators and mediators to assist in resolving investor-state conflicts?
5. How viable is diplomatic intervention by an investor's home state to resolve a dispute with the host state?

Dispute Resolution Measures in Investor–State Conflicts

1. Should dispute resolution measures be graduated? For example, should investors be required to first exhaust local remedies before domestic courts before instituting ISA proceedings?
2. Should ISA be retained or renegotiated by treaty or contract?
3. Is a two-tier 'domestic courts–ISA' approach more efficient and fairer?
4. Is a multi-tier approach preferable, commencing with dispute avoidance measures (such as negotiation) and concluding with dispute resolution measures (such as ISA)?
5. What are the optimal methods of preventing, avoiding, and resolving investor-state disputes?

18. See http://acci.asn.au/Research-and-Publications/Media-Centre/Media-Releases-and-Transcripts/Global-Engagement/Australian-Foreign-Investment-Requires-Right-to-Su.aspx (9 August 2012).

Project Methodology

Sustained multidisciplinary research on the social, economic and political impact of Australia's 2011 Trade Policy Statement is currently lacking, despite the importance of the issue. This project will investigate that impact in three stages, each of which is necessary to obtain an integrated view of the current situation, and to propose recommendations on arriving at efficient outcomes (as identified in the 'Background' set out in Part 1 above). It will:

(a) use econometric analysis to identify the strategic economic and political effect of ISA protections upon levels of inbound investment;

(b) use empirical data and case analysis to identify the impact of this policy on outbound investors, such as through the risk and cost of outbound investors being discriminated against by poorly governed host states; and

(c) undertake scholarly and doctrinal analysis of treaties, cases, academic articles and media literature to identify the potential risk of 'regulatory chill' resulting from treaty practice.

(i) Econometric analysis to identify the relationship between ISA protections and levels of inbound investment

The focus of this econometric study is Australia, its actual and potential trade and investment partners, and its inbound and outbound investors. The econometric analysis will serve several purposes: it will assist in building an economic model of FDI, an understanding of the significance of that model in the Australian government negotiating practice with respect to BITs and FTAs, as well as the economic and political impact of FDI for selected regional, country and country-pair characteristics (beyond Australia).

The project will develop an original econometric study to critically assess the economic and political links between inbound FDI and a host state's willingness to offer ISA protections. The literature is not settled on this issue. There are studies that find investment agreements have statistically significant effects on the nature and volume FDI. Berger et al (2010) found a positive impact on FDI, at least from regional investment treaties using appropriate methods to account for endogeneity issues, and having many zero values for the sample's dependent variable. Other studies show very little statistical or economic significance of such agreements for FDI (Bergstrand & Egger 2011).

Our systematic study will start with a theoretical model to ensure consistency in the choice of economic variables. It will extend from a 3-factor, 3-country, 2-good model (Egger & Pfaffermayr 2004; Baltagi et al 2007) to a 4-factor, 3-country, 2-good model. It will add natural resources as a factor in addition to labour, capital and human capital, to account for resource seeking FDI which is significant for a resource-rich country such as Australia (Armstrong 2011).

Our model will explicitly take third-country effects into account on grounds that investments between two countries are affected by characteristics (and changes in those characteristics) of neighbouring countries. Unlike fixed effects estimation and gravity model methods that implicitly take account of third-country, or multilateral, effects, some recent FDI models use inverse distance weighted effects to account for third-country effects. Gravity models of trade are used extensively to explain FDI, as trade and investment are deeply endogenous. However, there is evidence that knowledge-capital models of FDI significantly outperform gravity model-type FDI models, given that knowledge based models are derived from the behaviour of multinational enterprises and exporting firms (Blonigen 2005).

We will use a large global matrix of FDI flows and stocks to model the economic effects of investment treaties and contracts, as global flows and trends are required to estimate a robust counterfactual for understanding local data. A model that estimates only sub-regions or sub-samples can bias the results, with large one-off shocks in the data, especially with FDI data as it is typically 'lumpy'. A model that is based on a global sample requires regional, country-pair and country-specific controls to reach sensible and more precise findings that account for particular characteristics, trends and settings. We will test results against sub-samples for robustness. Our study will also follow Bergstrand & Egger (2011) in adopting careful econometric specifications that take account of, and exercise control over, the fact that investment agreements and FDI are determined internally, such as by state parties to BITs (Aisbett 2009). We will include up-to-date data, given that BITs have proliferated; FDI has continued to grow rapidly following the GFC; and ISA provisions in investment treaties have evolved.

The content of investment agreements varies with different ISA provisions, while varying generations of BITs have drastically diverse effects on investing firms. Many studies measure the effect of inward and outward investment agreements on FDI without accounting for these differences (Peinhardt & Allee 2011). Those studies that have taken account of different types of ISA provisions have typically only included two or three types of ISA provisions and have found significant distinctions between the effects of FDI between different generations of BITs. Our study will go further. We will take account of and measure variations in four types of ISA provisions, consistent with trends in the latest generation of investment agreements.

(ii) Empirical data and analysis of cases to identify the impact of this policy shift on outbound investors, such as through discrimination and corruption in host states

In addition, we will undertake original interview- and survey-based research to determine the risk of Australia's outbound investors facing bias or discriminatory attitudes in host states, in the absence of ISA. We will focus particularly on countries that are significant current or prospective investment destinations for Australian outbound investors, especially in the Asia-Pacific region.[19]

We will begin by closely analysing the results and approach of two studies relied on by PC, which strongly influenced the Government's 2011 Trade Policy Statement (PC 2010: 269). We will explore the various caveats expressed in those studies and assess the extent to which they represent a weak empirical foundation to support Australia's shift away from incorporating ISA provisions in future investment treaties.

The PC relied on one econometric study in general, namely, the World Bank's 'World Business Environment Survey (10000 business responses from 80 countries). That survey found that foreign firms enjoyed regulatory advantages not shared by their domestic equivalents, as reported by those firms themselves' (Huang 2005). However, that Survey was carried out back in 1999-2000. In addition, the PC did not mention that that study also found that such relative advantages disappeared when foreign investors were benchmarked against politically-connected domestic firms; there was even evidence that foreign investors were in fact disadvantaged (ibid, at p3). We will assess the significance of these factors in relation to Australia's policy towards ISA.

The PC also cited a related World Bank economic study which compared foreign and domestic investors. It found that the 'foreign privilege' phenomenon was stronger in Eastern Europe and South America compared to East Asia (ibid: 8). The political economic literature also shows that certain categories of FDI (especially resource-seeking versus market- and efficiency-seeking FDI) have less ex post bargaining power and so are more vulnerable to host country tactics (Kobrin 1987). Drawing on the World Bank survey, Desbordes & Vauday (2007) found that foreign investors self-reported that their political influence allowed them to obtain advantages (in influencing the content of proposed host state laws) compared to their domestic counterparts. To further test for economic and political risks faced by Australian (and perhaps other Asia-Pacific) investors in major emerging source destinations for FDI, particularly in Asia, we will create and implement a mail survey. This will include questions similar to those asked in the World Bank's 1999 Survey, such as Australian investors' sense of their political influence on law-making. However, it will ask further questions about their treatment in other dealings with the legal system (including regulators and the courts), in particular, whether and how their local counterparts might obtain relative advantages in these respects.

19. See generally Bath and Nottage (2015), available on request from the authors.

To keep this aspect manageable, the project will focus on Australian firms investing in several Asian countries included in the World Bank's 1999-2000 survey (notably Indonesia[20]) and others of present or anticipated interest to them (especially China and Vietnam). We will also survey organisations and individuals, such as law firms, familiar with investors' dealings in these countries.

Our project will draw on the CIs' extensive contacts with the legal profession and will involve website analysis, for example, of the Law Society's searchable database of solicitors' expertise. Through contacts of CIs' Kurtz and Nottage, we already have in-principle agreement to collaborate with the ACCI (for access to Australian investors), and the Emergency Committee for American Trade, along with CI Trakman's links to the North American Free Trade Agreement (NAFTA) Secretariats in the US, Canada and Mexico (for access to the views of North American businesses both in the US and Canada as a comparator). We will also approach organisations such as AUSTRADE for assistance in surveying their clients invested in or familiar with the five countries, and to pilot a draft questionnaire.

Unlike the World Bank Survey, we will conduct extensive semi-structured follow-up interviews of these Australian investors to clarify our understanding of their responses to questions regarding host state impediments, especially relating to whether and why they perceive that local investors face such impediments to a lesser degree. We envisage that more open-ended survey questions and the follow-up interviews will generate a representative range of case studies, highlighting challenges in the current regulatory environment faced by foreign investors in major Asian economies. We will propose that these challenges might be readdressed through tailored treaty protections. We will also interview business, government and international bodies, as well as NGOs, in Australia, Asia and North America, to obtain a broader perspective on responses from particular investors. We anticipate a total of about 80 interviews; most are expected to be carried out in Australia, but some will be conducted in Asia and North America, with each CI taking major responsibility for particular countries, as elaborated in Part E.1 below.

As part of this empirical study, we will organise two workshops, one with government representatives and the other with investor representatives. Both will take place in Year 2 of the project (2015). The Government Workshop will include the PC, AUSTRADE, Department of Foreign Affairs and Trade (DFAT), and Treasury. This will likely be hosted at the ANU. The Investor Workshop, including importers, exporters, the ACCI, insurers etc, will likely be held at UNSW. The purpose of each workshop will be to elicit comments and advice from workshop attendees, to open the door to ongoing communication, and to indicate an intention to circulate draft findings to them for feedback prior to the conclusion of the study. We believe that such participation will assist in developing the research project, rendering it more directly relevant to current risks and benefits associated with FDI, and assisting government and industry groups in going forward in often contentious and complex cases.

(iii) Scholarly analysis of treaties, cases, academic articles and media literature to identify the potential for regulatory chill resulting from treaty practice

The project will also undertake jurisprudential and case study research into the efficiency of ISA. It will address concerns about sovereignty on issues of public policy and fears of 'regulatory chill' emphasised by the Australian PC in its 2010 report. We will also undertake a comparative analysis of treaty practice in jurisdictions that have policy concerns somewhat analogous to Australia, such as Canada.

We will conduct a detailed analysis of investor-state arbitral cases on key treaty protections (especially guarantees of national treatment, fair and equitable treatment and compensation for direct and indirect expropriation). We will assess whether that jurisprudence has, either in law or fact, chilled or deterred further measures for environmental or other policy protections in that host state or elsewhere. This approach departs significantly from the PC's methodology of engaging in secondary and historical accounts of such jurisprudence.

We will examine all publicly available arbitration or other awards on this subject (cross-referencing databases such as those maintained by International Centre for Settlement of Investment Disputes, the United Nations Conference on Trade and Development, and the *Investment Arbitration*

20. See also now Nottage and Butt (2013) at http://ssrn.com/abstract=2340810 (examining existing and potential treaty claims by Australian investors, especially in the resources sector); Nottage (2014a). The World Bank survey also covered Malaysia and Philippines, but the funding allocated by the ARC for this project prevents a detailed analysis of those countries.

Reporter). Our aim is to identify the outer contours of arbitral jurisprudence on key treaty protections, especially national treatment, fair and equitable treatment, and guarantees against both direct and indirect expropriation. Our objective is to assess the likely risk profile of states regulating for key public purposes and, especially in the case of Australia, to compare those treaty protections against domestic (constitutional) law standards. We will pay particular attention to canonical cases involving environmental and health regulations in countries with domestic and regulatory systems comparable to Australia such as Canada in *SD Myers v Canada* (waste disposal measures), the US in *Methanex v US* (gasoline additive regulation) and Canada in *Chemtura v Canada* (pesticide ban).[21]

We will then supplement this examination of primary source material with a comprehensive review of the secondary literature, and information available from the government sector. We will place particular focus on the manner and extent to which investor reactions to treaty protections have, or are likely to, produce regulatory chill. We will continue to carefully monitor the ongoing investment treaty action by Philip Morris against Australia by evaluating whether its jurisdictional and substantive claims are likely to cause Australia and other countries in the region to adopt defensive action by which to shield themselves from comparable and future investor claims. The project will examine the likely nature of such a regulatory chill, varying from reluctance by states to conclude investment treaties, to not enacting legislation on controversial issues (such as the plain packaging of cigarettes) that may give rise to investor or other claims (Nottage 2013). In identifying and verifying such evidence, the CIs will consult with officials, public interest groups and business sectors involved in foreign investment, particularly in Asia. Consultation will vary from budgeted workshops to informal discussions and interviews – which we expect sometimes to overlap with the follow-up interviews from the survey outlined at (ii) above.

By closely examining these selected ISA awards (together with targeted survey information), we will assess the political and economic factors that lead foreign investors to commence ISA claims. We will weigh the adverse reputational costs of litigating against a state against the costs to investors of resorting to ISA (at least against certain states) that are sometimes ignored by those who assert that ISA gives rise to a regulatory chill. In particular, we will explore the factual matrices of ISA proceedings which demonstrate that foreign investors often first seek to litigate in the domestic courts of the host state and only commence ISA once the underlying relationship with the host state (especially in network industries) has broken down irretrievably. We will examine the extent to which investor recourse to domestic courts weakens the 'regulatory chill' thesis, and conversely, supports the legitimate role of ISA to enable foreign investors to bargain in the shadow of investment treaty protections.

Finally, we will systematically review leading treaty practice to identify techniques and strategies by which states other than Australia have balanced foreign investment protection against core regulatory autonomy. This comparative analysis is intended to extend beyond the analysis adopted by the PC and the Government's Trade Policy Statement (critiqued generally in Kurtz 2011; Nottage 2011; Burch et al 2012, Trakman 2014).[22] Canada, for instance, has successfully included general exemption provisions (modelled on provisions in the WTO) for every investment treaty it has signed since entering into the NAFTA. The US, instead, has carefully delineated the scope of operative obligations. The US's strategy has included linking any guarantee of 'fair and equitable treatment' to protections under customary international law, and grounding the guarantee against indirect expropriation in US constitutional doctrine.[23]

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21. On *Chemtura*, see Nottage (2015), with further references.
22. See also, updating and refocusing Nottage (2011), Nottage (2013a) (in a special issue on the international politics of resources in North Asia); and Nottage (2015), comparing KAFTA with earlier Australian and US treaty practice.
23. The EU is another important site for innovation in investment treaty practice as it is currently finalizing the substantive and procedural (including ISA) components of a model or template EU investment treaty, and recently entering into agreements (eg Canada or Singapore) and negotiating others (notably with the US) against that backdrop. More generally on the implications of intersections between international trade and investment law, see Kurtz (2013; 2014-5).

Significance and Innovations in Research and Concepts

This project is most important for policy-making in a crucial field for the world economy, at national, regional and global levels. The results will also contribute to important debate over whether the WTO or other multilateral bodies[24] should promote a new investment treaty framework and principles that govern pre- and post-establishment FDI.

The project will be significant in offering comprehensive and practical cost-benefit guidelines to both the Australian government and investors (inbound as well as outbound) in managing FDI. Importantly, it will draw attention to issues that Australia must take into account when negotiating treaties to ensure that it achieves an efficient balance between exercising its sovereignty over public policy issues and ensuring healthy participation in international investment markets.

Our research will be particularly significant for Asia-Pacific initiatives, such as the TPPA which is currently being negotiated and which represents the second largest potential trade and investment area after the EU. However, the analysis will impact on established non-treaty measures used to expand investment and trade in the region, notably via ASEAN and the Asia Pacific Economic Cooperation (APEC) forum. We will also add new perspectives and data to a major domestic debate on the merits and risks of the ISA system, especially for a nation like Australia in which investment in the resources sector is essential for the economy to thrive.

Our project will have significant methodological value as a multidisciplinary study by adding insights to various disciplines that have not been exploited in an integrated manner. We will use econometric analysis to formulate legal arguments on how Australia could temper its treaty practices to encourage investment, while maintaining effective control over its socio-economic and social concerns. We will draw on political science studies to further demonstrate the dynamics behind international treaty negotiations (eg Pekkanen 2012) and their impact upon domestic groups interested in or affected by ISA provisions (Nottage 2011). Scholars conducting econometric studies on investment and ISA (eg Berger et al 2010) rarely, if ever, engage in interview-based or other qualitative studies to triangulate their findings. Our project thus takes a novel and comprehensive approach by combining quantitative as well as qualitative methodologies.

The econometric method is particularly innovative. It builds upon and combines streams of literature in carefully measuring the impact of ISA provisions on FDI. The econometric analysis will: account for the different types of ISA provisions (Peinhardt & Allee 2011); include multilateral factors in a knowledge-capital framework for FDI modelling (Carr et al 2001; Markusen 2002); focus on East Asia/Australia-specific factors (including eg a natural resource endowment variable) (Armstrong 2011); and properly control the endogeneity issue arising from FDI and investment agreements being co-determined (Aisbett 2009; Bergstrand & Egger 2011).

Our legal analysis will draw, not only on public international law (the core sub-discipline for investment treaty law, and the overlapping sub-discipline of WTO law), but also on comparative law. The latter is essential to understand key attributes of foreign investment regulation in major Asia-Pacific economies, and related legal risks facing and protections accorded to foreign investors in host states, which may not (yet) be fully covered or implemented by treaty provisions. Our project is also conceptually significant in drawing from discourse in:

i. environmental regulation (to understand and assess 'regulatory chill');
ii. corporate governance (as a backdrop to regulating investor and dispute resolution behaviour and attitudes);
iii. international commercial arbitration (overlapping with treaty-based ISA insofar as a host state may consent to ISA through an investment contract, and some procedural features and jurists involved in ISA overlap with those in commercial arbitration: Nottage and Miles 2009; Trakman 2012); and
iv. international tax treaty law (to consider the costs and benefits of adapting dispute resolution provisions in that field to ISA) (Burch et al 2012).

24. See eg http://www.oecd.org/investment/internationalinvestmentagreements/publicconsultationisds.htm.

Feasibility and Communication of Results

Regarding time lines, we will conduct the econometric study of the impact of ISA provisions on inbound FDI throughout 2014.

We will commence the survey- and interview-based study of Australian outbound investors into major Asian economies in mid-2014 (after securing university Ethics Committee approvals). That will continue through to end-2015 (as follow-up interviews can be time-consuming). CI Nottage has extensive experience in undertaking such empirical work. He is also familiar with issues facing foreign investors in and out of Japan (Hamamoto & Nottage 2010), and in three of the countries targeted for our survey- and interview-based research (Bath & Nottage 2011).

The legal analysis of investment treaty awards and comparative treaty practice will begin in early 2014 and run to mid-2016. This part of the project will be relatively time-consuming (due to the large number of awards) and complicated by the fact that not all key awards are publicly available. Furthermore, treaty practice is deeply in flux as states experiment with different investment models and strategies.

At each stage of this project, we will produce working papers and scholarly articles communicating our analysis, findings and recommendations. We will draw on our proven track records as prolific authors of high-quality work in influential publications.[25] We will also incorporate key findings and recommendations in a co-edited or co-authored research monograph to be completed by the end of 2016.

A part-time Research Associate at UNSW will coordinate research and ensure that it operates efficiently. Four part-time Research Assistant positions, one based at each CI's institution, will be established for most of the project's duration. These RAs will assist in reviewing and disseminating project-related publications and work-in-progress on an ongoing basis, leading to the final monograph. We will maintain ongoing communication with Government and investor organizations. We will provide, and receive feedback on key economic data and on our empirical research and findings. We will build on our existing relationships with Government and Investor groups through a workshop with each group. One workshop will be held at the ANU and the other at UNSW, both in Year 2 (2015). These will be important occasions to communicate our preliminary findings.

The two workshops will provide an important opportunity: to engage in first-hand investigations into Government and investor practices; and to discuss key costs and benefits associated with FDI and ISA. The Government Workshop will include the PC, Treasury, AUSTRADE and DFAT. The Investor Workshop will include investor representatives, as well as importers, exporters, the Business Council of Australia, insurers etc. We will also canvass views of public interest and labour organisations such as the Cancer Council of Victoria (on the tobacco plain packaging dispute with Philip Morris) and the Australian Council of Trade Unions. We will catalogue responses at both workshops in relation to watershed developments, such as arise from the Philip Morris case and other novel investor-state claims.

Regular updates on our findings will be shared through online journals, such as *Transnational Dispute Management*, as well as on blogs (see, for example, CI Nottage's comprehensive blog on Japanese Law and the Asia Pacific).[26] Other communication channels will include the East Asia Forum, East Asian Bureau of Economic Research (EABER) and South Asian Bureau of Economic Research (SABER), with which CI Armstrong is closely affiliated.[27]

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25. Many of our published and forthcoming works are freely available via SSRN.com (including an earlier version of this paper).
26. See http://blogs.usyd.edu.au/japaneselaw/; and also the East Asia Forum blog co-edited by Armstrong, at http://www.eastasiaforum.org/tag/investor-state-dispute-settlement/.
27. See https://crawford.anu.edu.au/research_units/eaber/.

Conclusion: Expected Outcomes and Benefits

We expect the three stages of investigation in our project to establish:

(i) important links between ISA protections and levels of inbound investment, revealed through the econometric analysis;

(ii) viable responses to concerns of outbound investors about the availability of appropriate ISDS processes in host countries, in the absence of ISA; and

(iii) sustainable data demonstrating whether or not a complete renunciation of ISA is required to avoid regulatory chill in key areas of public policy, such as health and the environment.

Such findings will allow us to explore alternative methods of formulating efficient and fair methods of resolving investment disputes, including dispute prevention and avoidance measures. An underlying purpose will be to highlight functional ways in which Australia can present itself as an attractive investment destination, while giving its businesses the confidence to invest in key foreign jurisdictions, and balancing public interest concerns.

These research findings will generate significant **economic and social benefits** nationally, regionally and internationally. The project will demonstrate how dispute resolution measures can be effectively implemented in investment treaties and contracts. It will illustrate the risks and benefits that arise from particular formulations of those measures. On a social level, we will address issues such as 'regulatory chill' relating to measures adopted or considered by host states for environmental and public health protection. On the national level, it will focus on strengthening Australia as a key investment destination, while providing investor interest groups with reliable information on how to invest efficiently in Australia and abroad.

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